

# *Office of the State Auditor*

## *Division of State Audit*

### Public Service Commission Bismarck, North Dakota

Audit Report for the  
Biennium Ended June 30, 2007  
Client Code 408

*Robert R. Peterson*  
*State Auditor*



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## *Transmittal Letter*

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June 2, 2008

The Honorable John Hoeven, Governor  
Members of the North Dakota Legislative Assembly  
The Honorable Susan Wefald, President, Public Service Commission  
The Honorable Tony Clark, Commissioner  
The Honorable Kevin Cramer, Commissioner

We are pleased to submit this audit of the Public Service Commission for the biennium ended June 30, 2007. This audit resulted from the statutory responsibility of the State Auditor to audit or review each state agency once every two years. The same statute gives the State Auditor the responsibility to determine the contents of these audits.

In determining the contents of the audits of state agencies, the primary consideration was to determine how we could best serve the citizens of the state of North Dakota. Naturally we determined financial accountability should play an important part of these audits. Additionally, operational accountability is addressed whenever possible to increase efficiency and effectiveness of state government.

The in-charge auditor for this audit was Andrea Wike. Paul Deede, CPA was the staff auditor. Fred Ehrhardt, CPA, was the audit supervisor and Paul Welk, CPA, was the audit manager. Inquiries or comments relating to this audit may be directed to the audit manager by calling (701) 328-2320. We wish to express our appreciation to President Susan Wefald, Commissioners Tony Clark and Kevin Cramer, and their staff for the courtesy, cooperation, and assistance they provided to us during this audit.

Respectfully submitted,

Robert R. Peterson  
State Auditor

# *Executive Summary*

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## **INTRODUCTION**

The Public Service Commission is comprised of three Commissioners who are elected on a statewide basis to staggered six-year terms.

Dakota Territory established a Board of Railroad Commissioners in 1885, with general jurisdiction over railroads, sleeping car companies, express companies, and telegraph companies. At statehood, the Constitution of North Dakota provided for an election of a Board of Railroad Commissioners with powers and duties prescribed by law. In 1940, its name was changed to Public Service Commission (PSC). The Legislature has significantly broadened the duties of the PSC. Today, the Commission has varying degrees of jurisdiction over electric and natural gas utilities, telecommunications companies, weights and measures, grain elevators, auctioneers, reclamation of mined lands, the siting of energy plants and electric and natural gas transmission facilities, and, to a lesser degree, railroads. The Commission does not have jurisdiction over the rates of rural electric or telephone cooperatives or small telephone companies.

## **RESPONSES TO LAFRC AUDIT QUESTIONS**

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The Legislative Audit and Fiscal Review Committee (LAFRC) requests that certain items be addressed by auditors performing audits of state agencies.

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### *1. What type of opinion was issued on the financial statements?*

Financial statements were not prepared by the Public Service Commission in accordance with generally accepted accounting principles so an opinion is not applicable. The agency's transactions were tested and included in the state's basic financial statements on which an unqualified opinion was issued.

### *2. Was there compliance with statutes, laws, rules, and regulations under which the agency was created and is functioning?*

Yes.

### *3. Was internal control adequate and functioning effectively?*

Other than our finding addressing the "Fraud Risk Assessment/Control Activities" (page 13), we determined internal control was adequate.

4. *Were there any indications of lack of efficiency in financial operations and management of the agency?*

No.

5. *Has action been taken on findings and recommendations included in prior audit reports?*

There were no recommendations included in the prior audit report.

6. *Was a management letter issued? If so, provide a summary below, including any recommendations and the management responses.*

Yes, a management letter was issued and is included on page 17 of this report, along with management's response.

#### **LAFRC AUDIT COMMUNICATIONS**

1. *Identify any significant changes in accounting policies, any management conflicts of interest, any contingent liabilities, or any significant unusual transactions.*

There were no significant changes in accounting policies, no management conflicts of interest were noted, no contingent liabilities were identified or significant unusual transactions.

2. *Identify any significant accounting estimates, the process used by management to formulate the accounting estimates, and the basis for the auditor's conclusions regarding the reasonableness of those estimates.*

The Public Service Commission's financial statements do not include any significant accounting estimates.

3. *Identify any significant audit adjustments.*

Significant audit adjustments were not necessary.

4. *Identify any disagreements with management, whether or not resolved to the auditor's satisfaction relating to a financial accounting, reporting, or auditing matter that could be significant to the financial statements.*

None.

5. *Identify any serious difficulties encountered in performing the audit.*

None.

6. *Identify any major issues discussed with management prior to retention.*

This is not applicable for audits conducted by the Office of the State Auditor.

7. *Identify any management consultations with other accountants about auditing and accounting matters.*

None.

8. *Identify any high-risk information technology systems critical to operations based on the auditor's overall assessment of the importance of the system to the agency and its mission, or whether any exceptions identified in the six audit report questions to be addressed by the auditors are directly related to the operations of an information technology system.*

ConnectND Finance, Human Resource Management System (HRMS), Grain, Weights and Measures, and the Case Management systems are high-risk information technology systems critical to the Public Service Commission.

# ***Audit Objectives, Scope, and Methodology***

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## *Audit Objectives*

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The objectives of this audit of the Public Service Commission for the biennium ended June 30, 2007 were to provide reliable, audited financial statements and to answer the following questions:

1. What are the highest risk areas of the Public Service Commission's operations and is internal control adequate in these areas?
2. What are the significant and high-risk areas of legislative intent applicable to the Public Service Commission and are they in compliance with these laws?
3. Are there areas of the Public Service Commission's operations where we can help to improve efficiency or effectiveness?

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## *Audit Scope*

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This audit of the Public Service Commission is for the biennium ended June 30, 2007. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The Public Service Commission's sole location is its central office which will be included in the audit scope.

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## *Audit Methodology*

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To meet the objectives outlined above, we:

- Prepared financial statements from the legal balances on the state's accounting system tested as part of this audit and the audit of the state's Comprehensive Annual Financial Report and developed a discussion and analysis of the financial statements.
- Performed detailed analytical procedures including computer assisted auditing techniques. These procedures were used to identify high risk transactions and potential problem areas for additional testing.
- Tested internal control and compliance with laws and regulations which included selecting representative samples to determine if controls were operating effectively and to determine if laws were being followed consistently. Nonstatistical sampling was used and the results were projected to the population. Further where applicable,



populations were stratified to ensure that particular groups within a population were adequately represented in the sample, and to improve efficiency by gaining greater control on the composition of the sample.

- Interviewed appropriate agency personnel.
- Queried the ConnectND (PeopleSoft) ERP system. Given the complexity of the state's accounting system significant evidence was obtained from ConnectND.
- Observed Public Service Commission's processes and procedures.

In aggregate there were not any significant limitations or uncertainties related to our overall assessment of the sufficiency and appropriateness of audit evidence.

## ***Discussion and Analysis***

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The accompanying financial statements have been prepared to present the Public Service Commission's revenues and expenditures on the legal (budget) basis. The accompanying financial statements are not intended to be presented in accordance with generally accepted accounting principles (GAAP).

For the biennium ended June 30, 2007, operations of the Public Service Commission were primarily supported by appropriations from the state's general fund and federal revenue. This is supplemented by fees credited to the agency's operating fund.

### **FINANCIAL SUMMARY**

The Public Service Commission has significant amounts in Investments and Amounts Held for Others. The investments in the Abandoned Mine Reclamation Set-Aside Fund were \$2,258,846 for the year ended June 30, 2006 compared to \$2,410,282 for the year ended June 30, 2007. These investments are authorized by North Dakota Century Code section 38-14.2-04.

There is a Public Service Commission Trustee Account established in accordance with North Dakota Century Code section 60-04-03.1. In case of insolvency, the contents of a licensed warehouse must be considered an asset to the trust fund in accordance with North Dakota Century Code 60-02-44, which creates Amounts Held for Others. These amounts were \$8,446,376 for the year ended June 30, 2006 and \$10,303,574 for the year ended June 30, 2007.

Revenues consisted primarily of federal funds, as well as inspection and other regulatory fees and licenses and permits. Other revenues during the audited period included interest income, fines, and other miscellaneous revenue. There was an increase in Licenses, Permits, Fees, and Fines from \$1,567,182 for the year ended June 30, 2006 to \$2,636,475 for the year ended June 30, 2007. A majority of this increase was a result of the Siting Process Expense Recovery fund that was created by the 2005 Session Laws, Chapter 404, Section 1.

All other revenues remained fairly constant for the Public Service Commission, increasing only slightly. Total revenues were \$4,794,195 for the year ended June 30, 2007 as compared to \$3,465,316 for the year ended June 30, 2006.

Total expenditures for the Public Service Commission were \$4,866,233 for the year ended June 30, 2007 as compared to

\$3,974,368 for the prior year. The increase in total expenditures for the audited period reflects primarily capital payments for abandoned mine land (which also account for 23% and 21% of total expenditures for fiscal years 2007 and 2006, respectively). All other expenditures remained fairly constant except primarily for refunds.

Refunds had a significant increase due to North Dakota Century Code section 49-22-22 (3) creating a refund of the fees collected under the siting process expense recovery which exceeds the expenses incurred in the evaluation and designation process.

### ***ANALYSIS OF SIGNIFICANT VARIANCES BETWEEN FINAL BUDGETED AND ACTUAL EXPENDITURES***

The PSC expended \$8,366,243 of their appropriated funds for the biennium leaving a \$2,873,745 unexpended appropriation. The largest unexpended portion of the PSC appropriation was for Abandoned Mine Lands (AML) contractual services in the amount of \$1,741,851. The unexpended appropriation for AML contractual services was for abandoned coal mine projects that were not completed or were not started by the time the biennium ended at June 30, 2007. These projects are continued until completed but may be budgeted for in more than one biennium.

The other material unexpended portion of the PSC appropriation was for the Rail Rate Complaint Case in the amount of \$926,341. The unexpended appropriation for the Rail Rate Complaint Case was from the beginning farmer revolving loan fund for expenditures relating to the rail rate complaint case. These moneys are exempt from NDCC 54-44.1-11 and may be carried over to the next biennium.

## *Financial Statements*

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### **STATEMENT OF REVENUES AND EXPENDITURES**

<b><u>Revenues and Other Sources:</u></b>	<b><u>June 30, 2007</u></b>	<b><u>June 30, 2006</u></b>
Licenses, Permits, Fees, and Fines	\$ 2,636,475	\$ 1,567,182
Intergovernmental Grants/Contracts	1,895,976	1,731,451
Interest and Investment Earnings	193,907	120,993
Miscellaneous General Revenue	39,789	13,483
Transfers In	28,048	32,207
<b>Total Revenues and Other Sources</b>	<b>\$ 4,794,195</b>	<b>\$ 3,465,316</b>
<b><u>Expenditures and Other Uses:</u></b>		
Salaries and Benefits	\$ 2,530,853	\$ 2,466,271
Capital Payments	1,098,466	828,175
Refunds	363,068	
Travel	275,803	252,965
Fees and Services	181,127	96,921
Equipment	137,764	23,306
IT Services	84,971	97,394
Supplies	50,183	56,766
Professional Development	37,884	38,637
Miscellaneous Office Supplies	74,291	78,500
Transfers Out	31,823	35,433
<b>Total Expenditures and Other Uses</b>	<b>\$ 4,866,233</b>	<b>\$ 3,974,368</b>

## STATEMENT OF APPROPRIATIONS

For The Biennium Ended June 30, 2007

<b>Expenditures by Line Item:</b>	<u>Original Appropriation</u>	<u>Adjustments</u>	<u>Final Appropriation</u>	<u>Expenditures</u>	<u>Unexpended Appropriation</u>
Salaries and Benefits	\$ 5,122,832		\$ 5,122,832	\$ 4,996,283	\$ 126,549
Operating Expenses	1,408,153		1,408,153	1,330,489	77,664
Capital Assets	88,511		88,511	87,170	1,341
Grants	67,000	\$ (60,000)	7,000	7,000	
AML Contractual Services	3,668,492		3,668,492	1,926,641	1,741,851
Rail Rate Complaint Case	945,000		945,000	18,659	926,341
<b>Totals</b>	<u>\$ 11,299,988</u>	<u>\$ (60,000)</u>	<u>\$ 11,239,988</u>	<u>\$ 8,366,242</u>	<u>\$ 2,873,746</u>
<b>Expenditures by Source:</b>					
General Fund	\$ 4,362,837	\$ (60,000)	\$ 4,302,837	\$ 4,268,497	\$ 34,340
Other Funds	6,937,151		6,937,151	4,097,745	2,839,406
<b>Totals</b>	<u>\$ 11,299,988</u>	<u>\$ (60,000)</u>	<u>\$ 11,239,988</u>	<u>\$ 8,366,242</u>	<u>\$ 2,873,746</u>

### Appropriation Adjustments:

Senate Bill 2133 Section 2 of the 2005 legislative session created an appropriation of \$60,000, which was considered an emergency measure, for the purpose of refunding any siting process applications fees paid after August 1, 2004 for the biennium beginning July 1, 2005 to June 30, 2007. As this was an emergency measure, the appropriation was set up in the 2003-2005 biennium and the \$60,000 was available in that biennium. This appropriation adjustment was done to remove the appropriation from the 2005-2007 biennium as it was paid in the 2003-2005 biennium.

### Expenditures Without Appropriations Of Specific Amounts:

Performance Assurance Fund has a continuing appropriation authorized by NDCC section 49-21-31 (\$79,472 of expenditures for this biennium).

Insurance Recoveries Fund has a continuing appropriation authorized by NDCC section 54-44.1-09.1 (\$124 of expenditures for this biennium).

Siting Process Expense Recovery Fund has a continuing appropriation authorized by NDCC section 49-22-22 (3) (\$394,764 of expenditures for this biennium).

## *Internal Control*

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In our audit for the biennium ended June 30, 2007, we identified the following areas of the Public Service Commission's internal control as being the highest risk:

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### Internal Controls Subjected To Testing

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- Controls surrounding the processing of revenues.
- Controls surrounding the processing of expenditures.
- Controls effecting the safeguarding of assets.
- Controls relating to compliance with legislative intent.
- Controls surrounding the ConnectND (PeopleSoft) system.
- Controls surrounding the grain information system.
- Controls surrounding the weights and measures information system.
- Controls surrounding the case management information system.

The criteria used to evaluate internal control is published in the publication *Internal Control – Integrated Framework* from the Committee of Sponsoring Organizations (COSO) of the Treadway Commission.

We gained an understanding of internal control surrounding these areas and concluded as to the adequacy of their design. We also tested the operating effectiveness of those controls we considered necessary based on our assessment of audit risk. We concluded that internal control was not adequate noting a certain matter involving internal control and its operation that we consider to be a significant deficiency.

Auditors are required to report deficiencies in internal control that are significant within the context of the objectives of the audit. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect (1) misstatements in financial or performance information, (2) violations of laws and regulations, or (3) impairments of effectiveness or efficiency of operations, on a timely basis. Considering both qualitative and quantitative factors, we identified the following significant deficiency in internal control. We also noted other matters involving internal control that we have reported to management of the Public Service Commission in a management letter dated June 2, 2008.

## **FRAUD RISK ASSESSMENT/CONTROL ACTIVITIES**

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### **Finding 07-1**

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The Public Service Commission does not have a system in place to identify possible instances of fraud or fraudulent activities in the Public Service Commission's financial and operational areas.

The most important guidance relating to internal control is contained in *Internal Control – Integrated Framework* published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). This guidance dictates that a Fraud Risk Assessment program be established and practiced to identify risks of fraudulent type activities, including when special circumstances arise, when changing operating environments, and for restructuring. In addition, the Public Service Commission does not have the necessary control activities designed/documentated to ensure significant fraud exposures are identified and mitigated. Management must design the necessary internal controls to ensure that each of the significant fraud exposures identified during the risk assessment process are adequately mitigated.

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### **Audit Recommendation and Agency Response**

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#### **Recommendation:**

We recommend the Public Service Commission:

- Establish and perform a fraud risk assessment on a recurring basis.
- Design and document the necessary control activities to ensure that each significant fraud exposure identified during the risk assessment process has been adequately mitigated.

#### **Public Service Commission Response:**

*The Public Service Commission agrees with the recommendation and will begin implementation immediately by reviewing Office of Management and Budget Policy 216 Internal Control & Fraud/Significant Dishonest Act. The Public Service Commission will then develop the necessary policies and documents for fraud risk assessments and perform such assessments periodically.*



## *Compliance With Legislative Intent*

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In our audit for the biennium ended June 30, 2007, we identified and tested Public Service Commission's compliance with legislative intent for the following areas that we determined to be significant and of higher risk of noncompliance:

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### *Legislative Intent Included In Our Audit Scope*

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- Refunding the moneys collected in excess of the expenditures in the Siting Process Expense Recovery Fund (North Dakota Century Code section 49-22-22 (3)).
- Utilization of the Surface Mining and Reclamation Fund (North Dakota Century Code section 38-14.1-39).
- Determination on whether all public warehousemen and grain buyers have filed for a bond. Also, the controls in place to ensure that all public warehousemen and grain buyers have applied for a license. (North Dakota Century Code sections 60-02-09 and 60-02.1-08).
- Use of the trust fund established (North Dakota Century Code sections 60-02.1-30 and 60-04-03.1).
- Use of the funding provided for the State Rail Rate Complaint Case (2005 North Dakota Session Laws chapter 8, section 4).
- Proper distribution of the refunding any application fees paid after August 1, 2004 for the 2005-2007 biennium (2005 North Dakota Session Laws chapter 404, section 2).
- Proper use of the following legally restricted funds:
  - Performance Assurance fund;
  - Siting Process Expense Recovery fund; and
  - Credit-sale Contract Indemnity fund.
- Application of proper statutory rates relating to revenue, which includes the following fees:
  - Siting Process Expense Recovery application fee;
  - Public Warehouse license fee;
  - Grain Buyer license fee;
  - Roving Grain Buyer license fee; and
  - Fees for testing Weights and Measuring devices.
- Proper use of the State Treasurer (State Constitution, article X, section 12).
- Compliance with appropriations (2005 North Dakota Session Laws chapter 8).
- Compliance with OMB's Purchasing Procedures Manual.
- Travel-related expenditures are made in accordance with OMB policy and state statute.
- Proper use of outside bank accounts and proper authority for investments outside the Bank of North Dakota.
- Adequate blanket bond coverage of employees (NDCC section 26.1-21-08).
- Compliance with fixed asset requirements including record-keeping, surplus property, lease and financing arrangements in budget requests, and lease analysis requirements.

- Compliance with payroll related laws including statutory salaries for applicable elected positions and certification of payroll.

The criteria used to evaluate legislative intent are the laws as published in the *North Dakota Century Code* and the *North Dakota Session Laws*.

*Government Auditing Standards* requires auditors to report all instances of fraud and illegal acts unless they are inconsequential within the context of the audit objectives. Further, auditors are required to report significant violations of provisions of contracts or grant agreements, and significant abuse that have occurred or are likely to have occurred.

The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. Thus, we concluded there was compliance with the legislative intent identified above.

## *Operations*

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This audit did not identify areas of Public Service Commission's operations where we determined it was practical at this time to help to improve efficiency or effectiveness.

## ***Management Letter (Informal Recommendations)***

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June 2, 2008

The Honorable Susan Wefald  
President  
Public Service Commission  
600 E. Boulevard Avenue  
Bismarck, ND 58505

Dear President Wefald:

We have performed an audit of the Public Service Commission for the biennium ended June 30, 2007, and have issued a report thereon. As part of our audit, we gained an understanding of the Public Service Commission's internal control structure to the extent we considered necessary to achieve our audit objectives. We also performed tests of compliance as described in the same report.

Our audit procedures are designed primarily to enable us to report on our objectives including those related to internal control and compliance with laws and regulations and may not bring to light all weaknesses in systems and procedures or noncompliance with laws and regulations which may exist. We aim, however, to use our knowledge of your organization gained during our work to make comments and suggestions which we hope will be useful to you.

In connection with the audit, gaining an understanding of the internal control structure, and tests of compliance with laws and regulations referred to above, we noted certain conditions we did not consider reportable within the context of your audit report. These conditions relate to areas of general business practice or control issues that have no significant bearing on the administration of federal funds. We do, however, want to present our recommendations to you for your consideration and whatever follow-up action you consider appropriate. During the next audit we will determine if these recommendations have been implemented, and if not, we will reconsider their status.

The following present our informal recommendations.

### **ACCOUNTS PAYABLE/EXPENDITURES**

Informal Recommendation 05-1: We recommend that an appropriate individual at the Public Service Commission sign off on the hard copies of the journal vouchers done by OMB to indicate the Commission's approval that the journal vouchers are proper.

## **PAYROLL**

Informal Recommendation 05-2: We recommend that Public Service Commission implement procedures to ensure the One-Time Payment Query be run and approved monthly by an appropriate level of management.

Management of Public Service Commission agreed with these recommendations.

I encourage you to call myself or an audit manager, at 328-2241 if you have any questions about the implementation of recommendations included in your audit report or this letter.

Sincerely,

Andrea Wike  
Auditor in-charge